Proposed City Council Response to San Diego County Grand Jury Report
A NEW CITY HALL:
To be, or not to be? That is the question….

Clarification of Facts:

In June 2007, the City commenced a comprehensive and independent effort to seek a cost-effective, long-term solution to meeting the City's needs for customer-service centers, public-meeting facilities and office space downtown. This initiative was motivated by several pressing factors: (1) the City's leases for more than 500,000 square feet of privately-owned office space, executed many years ago at very favorable terms, were scheduled to expire in the years 2013 and 2014; (2) the facilities owned by the City located within the downtown Civic Center Complex were known to be in significant deteriorated physical condition and in need of rehabilitation; (3) City workers and the public were being exposed to potential unsafe conditions; and (4) the City's reliance on ever-increasing amounts of leased office space, combined with the exposure to fluctuations in the leasing market, was not a prudent strategy for leading the country's eighth largest city into the 21st century. In addition, the City recognized that anticipated reductions in the City work force, combined with technological advances made during the half-century since the current City Hall was built, created opportunities for cost-saving efficiencies through reductions in size and increases in functionality of office space in a new building. The three-year study concluded in July 2010 with a presentation to the City Council of the final results, showing that construction of a new modern and efficient City Hall within the downtown Civic Center Complex was the best near-term and long-term solution for the City and its taxpayers.

During the past twenty years, numerous studies and proposals have been evaluated to provide a long-term solution to this ever-increasing problem. This recent effort was the most extensive and far-reaching evaluation conducted to-date, analyzing nine different alternatives. In addition, sites located outside of downtown, including three City-owned sites, were evaluated for potential construction of a new City Hall, but deemed inadequate based upon inaccessibility, development and traffic constraints, soil contamination issues and other factors. Over the course of the three-year process, the country and San Diego encountered a dramatic economic recession and decline in the real estate market. Consequently, the analysis was continuously updated to reflect such changes, with analysis results and reports released in December 2008, May 2009 and June 2010. The study was conducted by numerous leaders in the real estate industry: DMJM H&N / AECOM (AECOM), Gensler Architects, Jones Lang LaSalle (JLL), Ernst & Young, Hines, Cumming Corporation, Economic Research Associates, Paladino and Associates, and Gerding Edlen Development. The study was managed by the Centre City Development Corporation (CCDC), the City's redevelopment manager for downtown.

Despite the extensive public record of this effort and the considerable knowledge of the independent experts enlisted to find the best solution for the City and its taxpayers, the

Grand Jury drew a number of inaccurate conclusions. It appears that the Grand Jury did not consider the most recently prepared public report dated June 2010 during their review. This information was made available to the public. Additionally, it appears that the Grand Jury did not recognize the following key facts:

- the City initially analyzed a total of nine separate alternative solutions for meeting its downtown needs, which included the extension of current leases based on "best and final" offers received from the City's three landlords and the purchase of the Civic Center Plaza (CCP) building; the analysis was refined after an extensive peer review process; and the City subsequently selected the two lowest cost alternatives for further analysis (the "Hold Steady" alternative and the New Civic Center alternative);
- the revised analysis and report comparing the "Hold Steady" and New Civic Center alternatives (dated June 2010) included updates to numerous factors including lease rates, construction costs, and City space requirements;
- an extensive physical condition report was prepared by AECOM, indicating the serious deteriorated physical condition of the existing City-owned buildings and their systems, the potential risks to the City, the estimated expense of necessary corrections, and the methods used to prioritize the recommended improvements and repairs;
- the City will require an estimated 472,000 square feet of contiguous leased space upon its existing lease expirations in 2013 and 2014, in minimum increments of 50,000 square feet. Few downtown buildings are expected to be able to provide this amount of space, particularly in close proximity to the existing Civic Center Complex. Therefore, the City's leasing requirements are not a typical "market" transaction and cannot be properly compared with the leasing fundamentals of smaller users;
- the City's bonding capacity is more than sufficient to finance large infrastructure projects, including this one. While the Grand Jury has an opinion as to the project's advisability, it produced no evidence that calls into question its financing feasibility.
- the proposed new City Hall building was designed with floor plates over two times larger than those of the buildings currently occupied by the City, and the new building would have 40% greater space efficiency than the existing buildings;
- the construction of a new City Hall on the Civic Center Complex site, as proposed, would create significant value to the City by freeing one or two full City blocks for future private development;
- the location of City Hall in the downtown core, adjacent to numerous public transit routes, provides low-cost access for the public and City workers (approximately 30% of City workers were shown via survey to utilize public transit);
- the current dispersion of City departments and workers among numerous buildings is inefficient, creates challenges for the public in conducting business, and is not cost-effective; and

- the costs of construction of a new modern and efficient City Hall cannot properly be compared to the costs of acquisition, repair and renovation of 30-50 year-old buildings without consideration of the buildings' remaining useful life, potential higher costs to operate, effect on worker productivity and space efficiency. Additionally, the lifespan of a new City Hall is anticipated to be significantly longer than that of an older existing building.

To further elaborate, contrary to the statement in the Discussion section of the Grand Jury report claiming that the City evaluated only two options to accommodate its future downtown office space needs, in reality the City initially evaluated nine different alternative long-term solutions to its downtown office and legislative space needs. Two options involved proposed new development and seven options included varying provisions for building rehabilitation, acquisition of the privately-owned CCP building, and continued leasing. Over the course of the three-year evaluation process, the comprehensive analysis of alternatives was prepared three separate times, reflecting the dramatic declines in the national and local economies and real estate markets; the reduction in the City's workforce; and reductions in construction costs and lease rates.

The first analysis, dated December 2008 (Attachment A), was prepared by the City's financial consultant, JLL. This analysis evaluated seven non-development alternatives to new construction, as well as competitive proposals received from two finalist developers to construct a new City Hall with the goal of accommodating the City's downtown office space needs for 50 years. During the course of the analysis, the national and local real estate markets significantly weakened and the leasing and development cost assumptions were updated to reflect the decline. The analysis underwent an extensive peer review process by the real estate practice group of the international accounting firm of Ernst & Young, resulting in a revised analysis dated May 19, 2009 (Attachment B).

The seven non-development alternatives considered various scenarios such as renovation of existing City-owned buildings, reconfiguration for improved efficiency and continued leasing of third-party space, acquiring the privately-owned CCP building, and conversion of the Concourse building to office space. The lowest cost non-development alternative, dubbed the "Hold Steady" alternative, was then selected for further evaluation and compared with the best of the two finalist proposals to construct a new City Hall.

The "Hold Steady" alternative assumed that the existing leases would be renewed for a period of approximately five years, and that minimal improvements to the City-owned buildings would be conducted in order to maintain safety and functionality for ten years, at which time a new City Hall would need to be constructed for replacement of the existing buildings. The lease renewal terms used in the analysis were based on "best and final" offers received from the City's three landlords of the existing leased office space. Requests for lease proposals were also sent to the owners of other Class "A" and Class "B" downtown office buildings that had, or were expected to have, at least 50,000 square feet of vacant space available. Those owners declined to submit proposals until such time that the City's existing leases were nearing their expiration, in 2013 and 2014. The statement made by the Grand Jury that extending existing leases was not seriously considered by the City is not only inaccurate, but is contradicted by documents that were made available to the public.

The final comprehensive analysis of the two lowest cost alternatives reflecting the continued deterioration of the real estate market, dated June 2010 (Attachment C), was prepared and presented to the City Council. It appears the Grand Jury did not consult this most recent analysis during its investigation. Numerous significant changes from the previous analysis included a reduction in the total size of the proposed new City Hall and amount of required leased space as a result of reductions in City staff; updated lease renewal terms based on new "best and final" offers from the City's existing landlords (dated December 2009), updated construction costs, and a reduction in estimated rehabilitation costs of the City-owned buildings. The Director of the Real Estate Assets Department asserted that the methods used to project annual lease terms were professionally sound and reasonable (Attachment D).

The final analysis concluded that new construction continued to remain the lowest cost viable alternative for the City, both in the near-term and long-term. The Grand Jury Report offers no information that overrides the breadth, authority or objectivity of that analysis.

Finding 01: *The existing city hall is in disrepair.*

> **Response: The City agrees with the finding.**
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> The Grand Jury Report, nonetheless, understates the nature and extent of this disrepair, and it undervalues the cost of remediation. The City engaged the international engineering firm of AECOM to prepare a comprehensive physical condition assessment of the existing City Administration Building (CAB) and three other City-owned buildings located within the four-square block Civic Center Complex. The assessment also included an evaluation of the adjacent privately-owned Civic Center Plaza (CCP) building, which is approximately 93% leased by the City. In the report of its findings dated April 2008 (Attachment E), AECOM identified numerous significant physical deficiencies in the CAB (constructed in 1964) and other buildings including structural, mechanical, roofing, electrical, plumbing, interior, fire-life safety, compliance with ADA guidelines and seismic elements. The deficiencies were prioritized by their relative urgency according to life-safety hazards for employees and members of the public, potential for major or catastrophic damage if not corrected, non-compliance with current building codes, and potential to interfere with the functionality of the buildings.
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> AECOM estimated that it would cost approximately $37.5 million to renovate the CAB building alone plus additional costs to seismically retrofit the concrete structure. If the City were to implement all of the renovations and repairs identified in the report, AECOM estimated the buildings' lives might be extended by up to an additional 30 years. Significant additional costs were also contained

in the report for extensive deficiencies in the City-owned Concourse, City Operations Building and Evan Jones Parkade, totaling $56.0 million. Additional costs of $11.2 million were estimated for the process of temporarily relocating employees during renovation, and $19.6-$33.6 million in costs were estimated for seismic retrofitting of the buildings to current building standards. A comparison of the 1964 Uniform Building Code and the 2010 California Building Code indicates that current design standards now require a lateral force that is more than double the code in force at the time the buildings were constructed, suggesting that a retrofit would be required to bring the structures into compliance with current code. In total, the estimated cost for full renovation of the four 45-year old buildings is $124.3 to $138.3 million.

In May 2009, AECOM prepared a supplemental physical condition assessment (Attachment F) for the CAB and other City-owned buildings within the Civic Center Complex. This supplemental report identified deficiencies requiring near-term repair or replacement so that the buildings could remain safe and functional for only five or ten more years, until a new City Hall building could be constructed. The estimated costs for the short-term renovations were $19.5 million for five years and $40.1 million for ten years. These amounts were adjusted in the most recently released cost analysis, dated June 2010, which was made available to the public.

To state that the current City Hall is in disrepair is both technically accurate and a gross understatement.

Finding 02: *The City has granted itself exemptions from established safety and habitability standards.*

Response: The City agrees with the finding.

In 1988, the Mayor and City Council passed Ordinance Number O-17172 requiring fire sprinkler retrofitting for high-rise buildings. Specific exemptions were granted, including all government buildings except for those owned by the City of San Diego. The only known occupied office buildings not in compliance at this time are the City Administration Building and the State of California downtown office building. This compliance deadline has been extended on several occasions, most recently on March 1, 2011 when the City Council extended the compliance period three years to January 31, 2014. The City entered into a contract with Aon Fire Protection Engineering to prepare construction specifications and design bridging documents to be issued for proposals for the design-build contract to design and construct the fire sprinkler system and perform asbestos abatement at the City Administration Building. It is estimated that this effort will be completed in the fall of this year. At that time, a request for proposals will be issued; and subsequently, the recommended proposal will be presented to the City Council for possible budget approval, authorization to expend funds, and award of the construction contract. This construction effort is expected to take approximately two years to complete.

Finding 03: *The published estimated city hall rehabilitation costs appear to be more than required to ensure public and employee safety.*

Response: The City agrees with the finding.

The independent buildings' physical condition assessment and related cost estimates for repair and rehabilitation were prepared by one of the largest and most experienced engineering firms, AECOM. As both the April 2008 and May 2009 AECOM reports indicate, the buildings' deficiencies and recommended rehabilitation were prioritized according to numerous factors, life-safety being only one of the factors. Other factors contributing to a deficiency line-item receiving a high priority ranking were those deficiencies that, if left uncorrected, could result in extensive, unnecessary taxpayer expense as a consequence of probable failure of critical mechanical, electrical, plumbing, structural or roofing systems, many of which were determined to be at or beyond the end of their useful life. The report also prioritized those building features in non-compliance with current ADA guidelines. While some of these deficiencies, if not corrected, may not pose an imminent threat to the health or safety of the public or employees, they pose the threat of rendering the buildings non-functional or uninhabitable for an extended period of time in the case of a sudden system failure. Many of the systems are old or original to the buildings' construction in the mid-1960s, and repair parts may no longer be available – in which case a system's failure would necessitate replacement.

For example, with regard to the City Administration Building (City Hall), the April 2008 AECOM report highlights that "The majority of this building's mechanical systems have reached or significantly passed the end of their life. The roof, possibly the original roof, is well beyond its useful life. Almost all of the interior areas feature outdated and energy inefficient lighting, plenum air supply in the ceilings, and poor condition finishes on floors, walls, and ceilings."

It is the City's responsibility to protect the taxpayer by mitigating risks associated with such deficiencies.

Finding 04: *Third-party building owners/leasing agents confirm a continued downturn in lease rates.*

Response: The City partially agrees with the finding.

According to several of the most respected office leasing specialists, lease rates appear to have reached their low point and may be expected to experience a slow recovery during the next year or two. According to Colliers International in their Spring 2011 San Diego office report, "The leasing environment continues to benefit tenants as free rent and other concessions are still prevalent. Rental rates…are poised to level out or even start to gradually increase during the second half of the year." The CB Richard Ellis First Quarter 2011 San Diego Office report claims "Lease rates appear to have bottomed out…" and anticipates an "…overall positive growth in office workers through year-end 2012." And finally, Cassidy Turley/BRE Commercial's 2011 San Diego Commercial Real Estate Forecast notes the "demand for office space is expected to improve slowly throughout 2011and accelerate further into 2012…"

Therefore, while several of the experts believe lease rates may have reached their low point, they generally believe that the market may be recovering during the next twelve months and lease rates may begin to rise. If the forecasts are accurate, it will negatively impact the City's future leasing costs. This is true because the City's current leases expire in 2013 and 2014, and any potential new landlords are not motivated to negotiate a new long-term lease until the time nears expected occupancy.

Notwithstanding the above opinions from leasing specialists, the estimated amount of rentable space that the City will require in 2013 and 2014, when the existing leases expire, is 472,000 square feet. It is impractical for the City to enter into a lease for less than 50,000 square feet of contiguous space for functionality, efficiency and cost-effectiveness purposes. Few opportunities are projected to exist for more than 50,000 square feet of Class "B" contiguous vacant office space in downtown during the next two to three years. For this reason, the lease terms to which the City will be subjected during its negotiations for renewal will not be typical market-rate pricing, as few spaces will exist from which to derive competition.

The Discussion section of the Grand Jury report stating that the City's consultant's analysis assumed renewal lease rates of $2.50-$2.75 per square foot is apparently based on an earlier outdated analysis, completed prior to the continued deterioration of the real estate market. The consultant's analysis dated June 2010, which the Grand Jury did not reference in its report, assumed lease rates averaging $2.17 per square foot, which were based upon "best and final" offer proposals received from the City's three landlords. The City has no evidence to support the Grand Jury's statement that 2011 market lease rates range from $1.70-$1.90 per square foot for contiguous spaces of 50,000 square feet or greater in downtown Class "B" office buildings.

Finding 05: *The $500/square foot estimated construction cost for the new building is inconsistent with the $200/square foot rate currently available for the purchase of existing buildings of sufficient size to accommodate the City's needs.*

Response: The City disagrees with the finding.

The costs of construction of a new modern and efficient City Hall cannot properly be compared to the costs of acquisition, renovation and repair of existing buildings without consideration of the buildings' remaining useful life, potential higher costs to operate, effect on worker productivity and space efficiency. Additionally, the lifespan of a new City Hall is anticipated to be significantly longer than that of an older existing building.

The City received a letter dated July 13, 2010 from J.P. Morgan indicating the Civic Center Plaza (CCP) building may be available for purchase at a price of $200 per square foot, but this letter provided no proposed details regarding potential terms for such a purchase (Attachment H). Based on the letter from J.P. Morgan, the College Building, which is adjacent to the CCP, would be included as part of a contemplated purchase. The College Building has not been evaluated by the City or its consultants; and, as with the CCP, a due diligence process with respect to a potential acquisition would be warranted.

The City is also aware that a First Right of Refusal is recorded on the CCP building, which provides Rock Asset Management, the master lessee, with a priority in purchasing the property in the event a bona fide offer is received from a third party. Assuming the City could have the opportunity to acquire the CCP building, the building is 39 years old and would require millions of dollars in rehabilitation, according to the AECOM report dated April 2008. Additionally, reconfiguration of workspace for efficiency and code compliance improvements would be needed. CCP's life expectancy would be significantly less than a new building, and CCP would be far less efficient, even after space reconfiguration, as a result of its relatively small floor plates. The new proposed City Hall building would be 40% more space efficient than the City's currently owned and leased facilities. Therefore, a comparison based solely on construction costs of a highly efficient building with the acquisition costs of a 39 year-old inefficient building that requires significant additional investment, while ignoring the long-term benefits and expenses, is not valid.

Furthermore, acquiring the CCP building would not solve any of the City's other building occupancy problems, such as the need for significant required rehabilitation of existing City-owned buildings, estimated to cost tens of millions of dollars; the inefficiencies of existing buildings and workspace; the dysfunctional dispersion of staff among numerous buildings; and the need to continue to lease office space in the future. Any solution the City would consider must be a comprehensive long-term solution, rather than a quick-fix.

Recommendation 11-38: *Obtain cost information from current lessors for extending lease agreements beyond existing termination dates.*

Response: The recommendation has been implemented.

The City last requested "best and final" offers for lease renewal terms from its three landlords in December 2009. Those responses resulted in an average lease renewal rate of $2.17 per square foot based on a five-year renewal term and no tenant improvement allowance. During the next twelve months, the City will be formulating a strategy to provide workspace for its employees in the most cost effective manner possible. This will include requesting offers for renewal of its existing leases, as well as seeking offers from landlords of other Class "B" downtown office buildings for a minimum of 50,000 square feet of contiguous available space.

Recommendation 11-39: *Determine if departmental downsizing will allow for a long-term reduction in leased space requirements.*

Response: The recommendation has been implemented.

The City has reduced staff during the past few years in reaction to decreased revenues. Departments have been consolidated and realigned to improve efficiencies and reduce space requirements where possible. The most recent financial analysis of the alternatives, dated June 2010, incorporates the recent staff downsizing into the City's current and future space needs estimates. The analysis concluded that the construction of a new City Hall eliminates the need for the City to lease downtown office space until 2035.

Recommendation 11-40: *Re-evaluate and report the costs associated with retrofitting the existing city hall, considering minimum/maximum expenses along with public safety.*

Response: The recommendation will not be implemented because it is not warranted and is not reasonable.

AECOM performed an extensive review of the physical deficiencies of the four City-owned buildings located within the Civic Center Complex in 2008 and 2009. No significant improvements have been performed on the buildings since the time the AECOM reports were issued, and thus the buildings' conditions have remained the same or have further deteriorated. Construction costs may have changed since the analyses were completed, but incurring the cost of a new estimate is not warranted until the work is being contemplated for completion or in the case where the City conducts a future comprehensive analysis on the future of City Hall.

Recommendation 11-41: *Re-examine purchase options for temporary and permanent solutions.*

Response: The recommendation has not yet been implemented, but will be implemented in the future.

As lease alternatives become available, the City will examine them. The City will examine all viable options to provide space for its employees. This will include leasing, purchase of existing buildings and possibly, new construction. The most efficient and cost effective alternative will brought before City Council for approval. These actions will be implemented by December 2012.

Recommendation 11-42: *Re-examine and report current construction costs and cost savings vs. those used in 2008 and 2009.*

Response: The recommendation has been implemented.

The occupancy cost analysis was most recently updated in June 2010, which is not referenced in the Grand Jury report.

Recommendation 11-43: *Inform voters and other interested parties about the future of San Diego city hall.*

Response: The recommendation has been implemented.

During 2008, no fewer than nine advertised public meetings were held in each of the Council districts throughout the City with presentations to inform the voters and the community about the analysis alternatives, methodology and results. Questions and comments from the public were documented, posted online and presented to the City Council. In addition, presentations were given to at least 39 different community and stakeholder groups about the alternatives and analysis results. Additional public and stakeholder meetings were held in May 2009 and July 2010 in which the revised financial results were presented (Attachment G). The public was well-informed during the entire evaluation process. All analysis results and supporting studies were posted on the website of CCDC for public review.

Attach: Attachment A - JLL analysis dated December 2008
Attachment B - JLL analysis dated May 19, 2009
Attachment C - JLL analysis dated June 2010
Attachment D - Opinion of the Real Estate Assets Department Director
Attachment E - AECOM physical condition report dated April 2008
Attachment F - AECOM supplemental physical condition report dated May 2009
Attachment G - List of public and stakeholder group meetings and comments
Attachment H – Civic Center Sale Proposal

Please note that due to the size of the attachments listed above, they can be obtained online at www.sandiego.gov/iba/reports/reports11.shtml